

REPORT OF EXAMINATION  
OF THE  
MERITPLAN INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2008

Participating State  
and Zone:

California

Filed June 29, 2010

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Los Angeles, California  
May 28, 2010

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Christina Urias  
Secretary, Zone IV-Western  
Director of Insurance  
Arizona Department of Insurance  
Phoenix, Arizona

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

MERITPLAN INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office and the primary location of its books and records, 3349 Michelson Drive, Suite 200, Irvine, California 92612.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2008. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2008, as deemed necessary under the circumstances.

This examination was conducted concurrently with the examinations of the Company's parent, Balboa Insurance Company, an affiliate, Balboa Life Insurance Company, and with the Arizona Department of Insurance's examination of the Company's affiliate, Newport Insurance Company.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; business in force by states; loss experience; accounts and records; and sales and advertising.

### SUBSEQUENT EVENTS

Subsequent to the examination date, and in its 2009 annual statement filing, the Company reported net realized capital losses of \$4.8 million mainly related to its residential mortgage-backed securities (RMBS) \$2.7 million, and to a lesser extent, commercial mortgage-backed securities (CMBS) \$2.1 million.

Also, subsequent to the examination date, the Company reported an increase in surplus of \$446,010 due to the cumulative effect of changes in accounting principles regarding the valuation and impairment of securities. This reported amount is calculated based on Statements of Statutory Accounting Principles (SSAP) 43R which supersedes SSAP 98 and revises the basis for valuation and impairment requirements from fair value to the cash flows to be collected for the securities..

### COMPANY HISTORY

The Company is a wholly-owned subsidiary of Balboa Insurance Company (BIC). On February 26, 2008, Bank of America Corporation (BAC), a publicly traded company on the New York Stock Exchange and incorporated in the State of Delaware, filed a Form A application with the California Department of Insurance (CDI) pursuant to California Insurance Code Section 1215.2 seeking

approval to acquire control of BIC, the Company, and two Company affiliates, Newport Insurance Company and Balboa Life Insurance Company. The CDI approved the Form A application on June 16, 2008. On July 1, 2008, BAC acquired the Company's former ultimate parent, Countrywide Financial Corporation (CFC), a publicly traded company incorporated in the State of Delaware, thereby becoming the Company's ultimate parent. On November 7, 2008, one of BAC's subsidiaries, Effinity Financial Corporation (EFC), acquired all but one share of the stock of the Company's parent, BIC, from its previous parent, Balboa Insurance Group, Inc. (BIG), a California holding company. The single share not purchased by EFC is held by the Company's affiliate, BLIC. Thus, after the acquisition, the Company remained a wholly-owned subsidiary of BIC. On April 27, 2009, EFC was merged into NB Holdings Corporation and the Company was transferred within the BAC organization structure from EFC to BA Insurance Group, Inc.

On June 28, 2006, the Company amended its Articles of Incorporation changing the par value of its capital stock from \$12 to \$24 per share. The number of outstanding shares of its capital stock, 235,000 owned by BIC, remained unchanged during the examination period. The Company received a \$30 million contribution from BIC in September 2006, in part to fund the increase in the par value per share amount. Common capital stock increased by \$2,820,000 to \$5,640,000 and the remaining \$27,180,000 was contributed to gross-paid in and contributed surplus, in accordance with the June 28, 2006 amendment to its Articles of Incorporation.

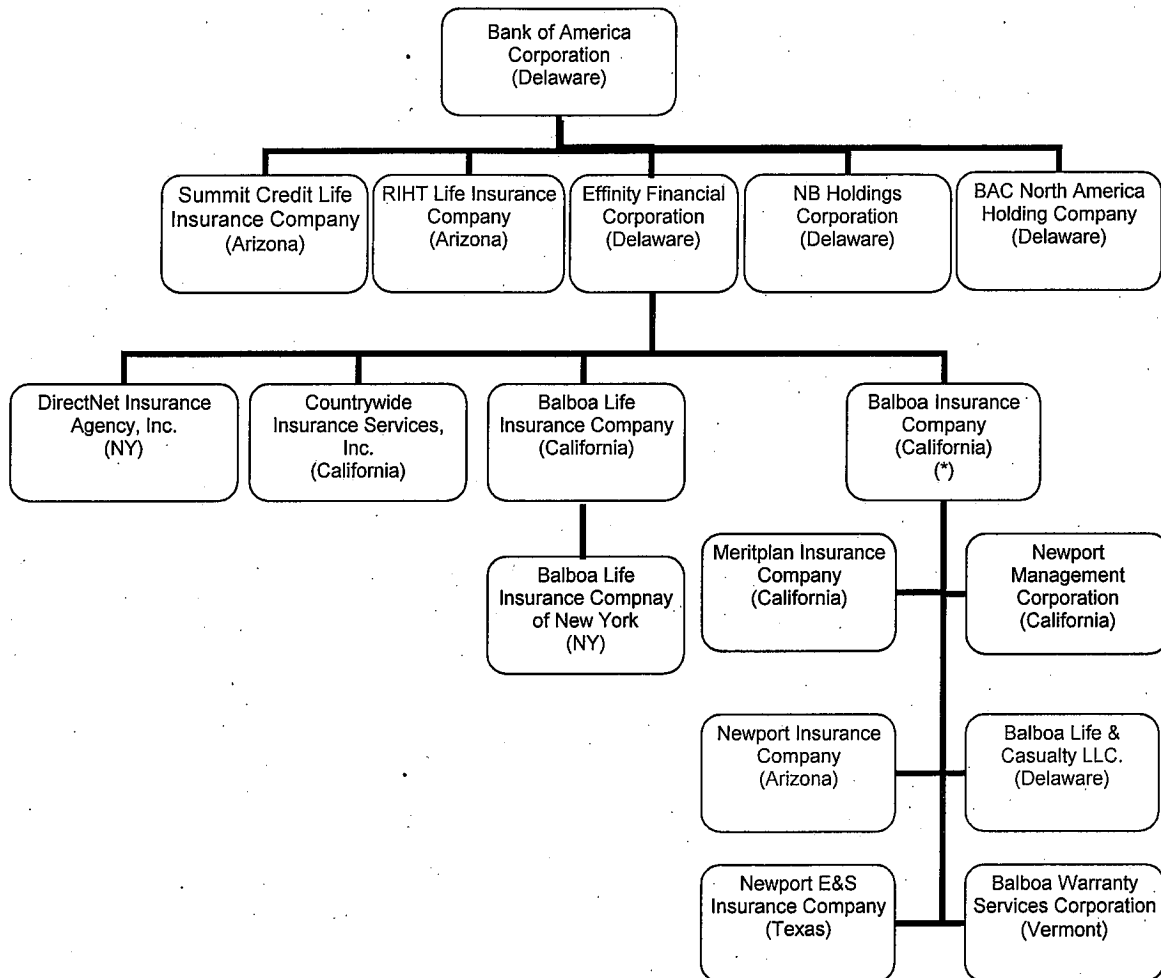
In September 2006, BIG contributed \$30 million in cash and securities to BIC, and as previously discussed above, contributed \$30 million in cash and securities to the Company.

#### MANAGEMENT AND CONTROL

The two abridged organizational charts below, illustrated as of December 31, 2008 and December 31, 2009, show the changes in the Company's holding company system as discussed in the Company History section of this report. The charts are limited to the Company's parent, its ultimate

controlling parent, and some affiliated companies, and depicts the Company's relationships within the Bank of America Corporation holding company system:

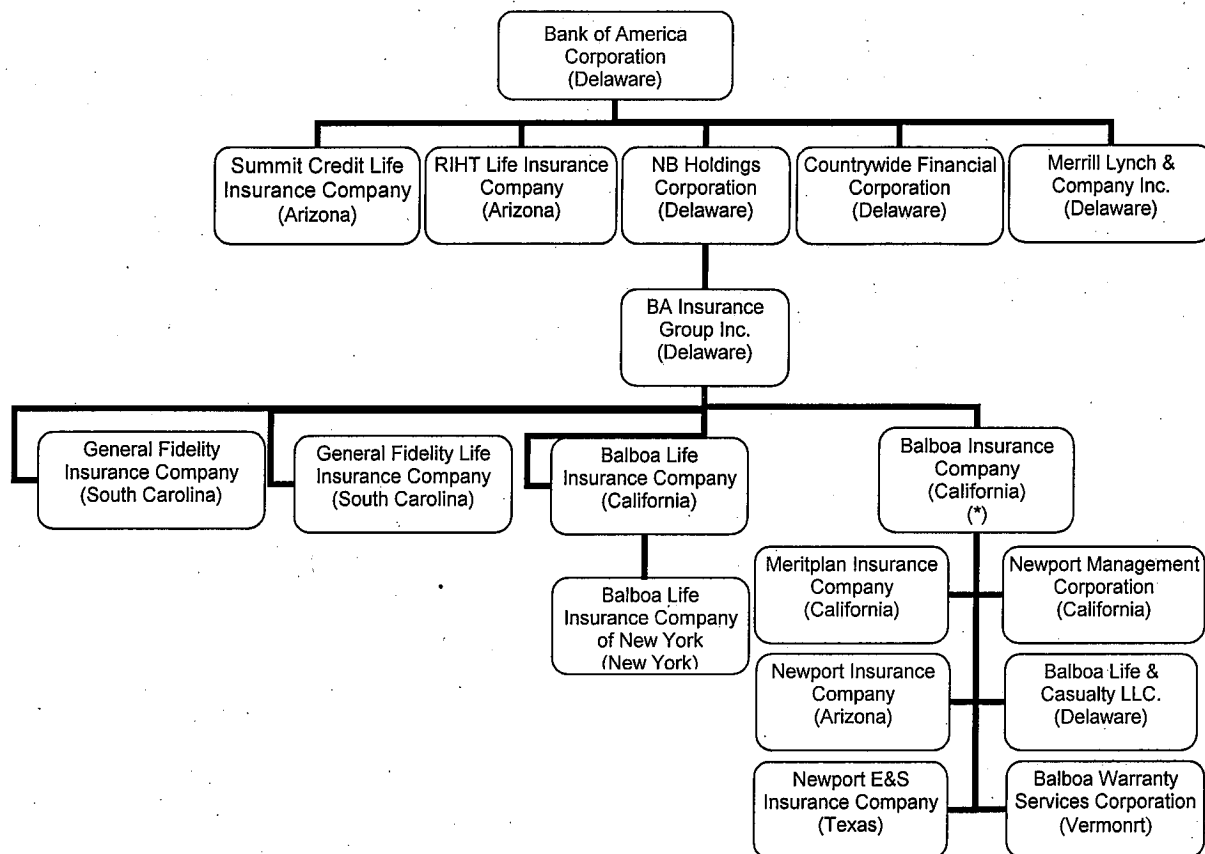
As of December 31, 2008:



(All ownership is 100%, except as otherwise noted)

(\*) Balboa Life Insurance Company owns one share of stock out of the 25,000 issued and outstanding shares of Balboa Insurance Company

Subsequent to the examination date, and as of December 31, 2009:



(All ownership is 100%, except as otherwise noted)

(\*) Balboa Life Insurance Company owns one share of stock out of the 25,000 issued and outstanding shares of Balboa Insurance Company

Management of the Company, its parent, Balboa Insurance Company, and affiliates, Newport Insurance Company and Balboa Life Insurance Company is vested in a board of directors with no less than seven members elected annually. The Company was not in compliance with its by-laws regarding the minimum number of directors as of December 31, 2008, but has remediated the deficiency as of the date of this Report of Examination. A listing of the members of the board and principal officers serving on December 31, 2008 follows:

## Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Franklin T. Dunn (*) Anaheim Hills, California	General Counsel and Secretary BA Insurance Group, Inc.
W. Myron Hendry (**) Irvine, California	Chief Operations Officer BA Insurance Group, Inc.
Robert V. James (***) Dana Point, California	President BA Insurance Group, Inc.
Mark A. McElroy Santa Ana, California	Insurance Executive BA Insurance Group, Inc.
Kenneth L. Mertz Oak Park, California	Finance Executive BA Insurance Group, Inc.

## Principal Officers

<u>Name</u>	<u>Title</u>
Robert V. James (***)	President
Kenneth L. Mertz	Senior Vice President, Chief Financial Officer
Franklin T. Dunn (*)	Secretary, Chief Legal Counsel
Laurie A. Fitzgerald	Senior Vice President, Chief Risk Officer
Mark A. McElroy	Senior Vice President
Harvey Waite	Senior Vice President, Chief Actuary
W. Myron Hendry (**)	Senior Vice President, Chief Operations Officer

(\*) Resigned as Board Member effective March 1, 2009

(\*\*) Resigned as Senior Vice President, Chief Operations Officer, and Board Member, effective November 27, 2009

(\*\*\*) Resigned as President and Board Member, effective January 15, 2010

The Company, its parent, Balboa Insurance Company and its affiliates, Balboa Life Insurance Company, and Newport Insurance Company have experienced significant changes in its board of



directors and management during and subsequent to the examination period. The resignations have included nine members from the Board and seven executive officers, including the President, Mr. Robert James. As of the date of this Report of Examination, a new President has not been appointed.

#### Management Agreements

Balboa Insurance Group Intercompany Services Agreement: Effective January 1, 2006, the Company entered into an Intercompany Services Agreement (Intercompany Services Agreement). Parties to the Intercompany Services Agreement were: the Company, Balboa Insurance Company (BIC), Balboa Life & Casualty LLC (BLC), Balboa Life Insurance Company (BLIC), Newport Management Corporation (NMC), Newport Insurance Company (NIC), Newport E&S Insurance Company (Newport E&S), Balboa Life Insurance Company of New York (BLICNY), Balboa Warranty Services Corporation (BWSC), Insurance Automation Corporation (IAC), Countrywide Insurance Services, Inc. (CIS), Countrywide Insurance Services of Arizona, Inc., Countrywide Insurance Services of Texas, Inc., DirectNet Insurance Agency, Inc. (DirectNet), and DirectNet Insurance Agency of Arizona, Inc., collectively known as the Group Members.

Under the Intercompany Services Agreement, BIC had the option of providing information system services, electronic data processing, accounting and financial functions, underwriting, claims adjusting and payment processing, legal services, actuarial services, and marketing functions to the Group Members, with the Group Members reimbursing BIC for the actual cost of the services provided. In addition, BLC also had the option of providing the Group Members with the aforementioned services, along with payroll services and facilities on an actual cost basis. Under the terms of the Intercompany Services Agreement, the Company compensated BLC for the 2006, 2007, and 2008 years, \$11 million, \$35 million, and \$51.8 million, respectively. The California Department of Insurance (CDI) approved this agreement on February 27, 2006.

On December 31, 2008, the parties to the above Intercompany Services Agreement, terminated the agreement, and the Company entered into a new Intercompany Services Agreement (BAC

Intercompany Services Agreement), effective January 1, 2009. This new agreement was entered into because of changes in affiliations made under the Bank of America Corporation (BAC) holding company system that became effective July 1, 2008. Under the BAC Intercompany Services agreement, BIC and BLC continue to provide many of the same intercompany services on an actual cost basis as listed in the prior Intercompany Services Agreement. In addition, under this new agreement, the parties have more flexibility to perform or procure services from any of the participating members. The parties to the BAC Intercompany Services Agreement include: the Company, BIC, BLIC, NMC, NIC, BLICNY, BLC, BWSC, CIS, Countrywide Financial Corporation, Countrywide Home Loans, DirectNet, BA Continuum India Private Limited, BA Continuum Costa Rica, BA Continuum solutions Private Limited, Banc of America Insurance Services, Inc., BA Insurance Services, Inc., Bank of America, N.A., Banc of America Card Servicing Corporation, and BAC. The CDI approved this agreement on April 10, 2009.

Investment Management Agreement: Effective April 17, 2000, the Company, BLIC, MIC, NIC, and IAC entered into an Investment Management Agreement with an affiliate, Countrywide Home Loans, Inc. (CHL). In accordance with the Company's investment guidelines, CHL provides investment management services and is compensated based on actual expenses incurred. The CDI approved this agreement on November 2, 2000. The Company did not pay any fees in 2006, but in 2007 and 2008, the Company paid \$288,129 and \$243,633, respectively, in investment and miscellaneous fees to CHL under the terms of this agreement.

Effective November 15, 2008, the Investment Management Agreement with CHL was terminated, and the Company, BIC, BLIC, and NIC entered into an Investment Management Agreement with another affiliate, Columbia Management Advisors, LLC (CMA). Under the terms of this agreement, CMA provides investment advisory services and manages the investment portfolios of the Company, BIC, BLIC, and NIC. CMA is compensated based on an annual asset-based fee calculated at 0.05 percent of all assets under management. The Company, BIC, BLIC, and NIC did not pay any investment or miscellaneous fees to CMA in 2008. The CDI approved this agreement on November 7, 2008. Effective May 1, 2010, the long-term fixed income and equity asset management business

of CMA was sold to a non-affiliate, RiverSource Investments, LLC, the asset management arm of Ameriprise Financial, Inc. As a part of that sale, the Investment Management Agreements were assigned to RiverSource Investments, LLC.

Consolidated Federal Income Tax Allocation Agreement: Under the terms of a Consolidated Federal Income Tax Allocation Agreement effective on and approved by the CDI on November 2, 2000, the Company, its parent, various affiliates, and its ultimate parent, Countrywide Financial Corporation (CFC) filed consolidated federal income tax returns through June 30, 2008. This agreement was terminated on June 30, 2008, as Bank of America Corporation (BAC) acquired CFC on July 1, 2008.

Effective July 1, 2008, the Company, its parent, various affiliates, and its ultimate parent, BAC, entered into a new Consolidated Federal Income Tax Allocation Agreement. Pursuant to the new agreement, the Company's tax liability is the same as it would have been had it filed on a separate, stand-alone basis. The CDI approved this agreement on December 10, 2009. The Company paid the following taxes during the examination period:

<u>Year</u>	<u>Amount</u>
2006	\$ 326,575
2007	1,493,583
2008	<u>18,785,659</u>
Total	<u>\$ 20,605,817</u>

#### TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to transact multiple lines of property and casualty insurance. The following is a listing of the states in which the Company is licensed:

Alabama	Indiana	Missouri	Oklahoma
Arizona	Iowa	Montana	Oregon
California	Kansas	Nebraska	Pennsylvania
Colorado	Kentucky	Nevada	South Carolina
Connecticut	Louisiana	New Jersey	Tennessee
Delaware	Maryland	New Mexico	Texas
Florida	Michigan	New York	Utah
Georgia	Minnesota	North Carolina	Washington
Hawaii	Mississippi	Ohio	Wisconsin
Idaho			

The Company specializes in lender placed insurance through financial institutions, including automobile collateral protection, property collateral protection, credit involuntary unemployment, and homeowners. The principal lines of business written are fire, allied, auto physical damage, and homeowners. In 2008, the Company wrote direct premiums totaling \$405.4 million and the majority of the business was written in the following four states:

State	Direct Premium Written	Percentage of Total
California	\$ 130,054,894	32.1%
Texas	77,374,660	19.1 %
Michigan	45,670,764	11.3 %
Colorado	39,825,812	9.8 %

Business is primarily marketed and produced through a combination of agencies affiliated with financial institutions and general and independent agents. Banc of America Insurance Services, Inc., an affiliated general agent, is the largest producer. There are approximately 57 general agents and 3,543 independent agents affiliated with the Company.

On August 1, 2004, the Company, Balboa Insurance Company (BIC), Newport Insurance Company (NIC), and Newport E&S Insurance Company (Newport E&S) entered into an agency agreement with Arrowhead General Insurance Agency, Inc. (Arrowhead). Under the terms of this agreement,

Arrowhead had the authority to accept applications and issue homeowners and automobile insurance policies on behalf of the companies. As compensation, Arrowhead received advance commissions and contingent commissions based on loss experience. Effective December 5, 2007, the previous agency agreement was terminated and the Company, BIC, Newport E&S, and NIC entered into a Managing General Agency Agreement with Arrowhead. The contract terms were largely unchanged from the previous agency agreement, with the exception of the regulatory requirements specific to managing general agents. In June 2009, subsequent to the examination date, the Company, BIC, NIC, Newport E&S, and Arrowhead reached an agreement to terminate the Managing General Agency Agreement as of June 30, 2010.

Effective April 28, 2005, the Company, BIC, and NIC entered into an agency agreement with Carnegie Agency, Inc. (Carnegie). Under the agreement, Carnegie had the authority to accept applications and issue California automobile insurance policies on behalf of the companies. As compensation, Carnegie received advance commissions and a contingent commission based on earned premiums. Effective March 15, 2007, the previous agency agreement was terminated and the Company, BIC, and NIC entered into a Managing General Agency Agreement with Carnegie. The contract terms were largely unchanged from the previous agency agreement, with the exception of the regulatory requirements specific to managing general agents. Effective April 8, 2010, subsequent to the examination date, the Company, BIC, NIC, and Carnegie terminated the Managing General Agency Agreement, with the exception of basic renters' policies which were written until May 1, 2010.

Effective June 1, 2005, the Company, BIC, and NIC (Balboa Group) entered into a Strategic Alliance Agreement with Atlantic Mutual Insurance Company and Centennial Insurance Company (Atlantic Mutual Group). Under the agreement, the Balboa Group and the Atlantic Mutual Group wrote high-value homeowners insurance and affiliated products developed by the Atlantic Mutual Group. In addition, the Balboa Group marketed policies in certain jurisdictions where the Atlantic Mutual Group did not offer policies. On December 31, 2007, the Atlantic Mutual Group sold its assets to ACE American Insurance Company (ACE). As a result, the Strategic Alliance Agreement was

terminated, effective December 31, 2007. The business written by the Balboa Group through Atlantic Mutual was ceded to ACE through a 100% quota share reinsurance agreement. In addition, all Atlantic Mutual Group homeowner business written on the Balboa Insurance Group paper is being run-off and will not be renewed upon their current policy expiration.

During 2006, 2007, and 2008, Arrowhead, Carnegie, and Atlantic Mutual produced a total of \$80.4 million, \$74.5 million, and \$65.5 million, respectively, in direct written premiums for the Company.

### GROWTH OF COMPANY

The Company has experienced significant growth since the last examination through 2009 as shown in the following schedule:

<b>Year</b>	<b>Admitted Assets</b>	<b>Surplus as Regards Policyholders</b>	<b>Gross Premiums Written</b>	<b>Net Premiums Written</b>	<b>Net Underwriting Gain/(Loss)</b>	<b>Net Income</b>
2005	\$ 88,651,261	\$ 20,390,832	280,724,477	40,953,770	(173,709)	(131,996)
2006	102,010,758	57,011,582	305,984,856	38,498,258	5,217,982	4,922,708
2007	140,323,388	66,377,805	456,564,253	59,105,985	10,769,967	8,325,734
2008	183,993,166	84,830,614	471,359,695	65,982,177	21,730,080	18,091,307
2009	204,373,768	100,856,869	709,817,720	72,214,153	28,300,670	17,348,421

The Company is a leading provider of lender placed insurance to financial institutions and their end customers, firmly establishing itself within this specialized market. This market niche has lead to higher premium volumes during the examination period, as its lender placed lines experienced significant growth in real estate business due to the rise in foreclosures.

## REINSURANCE

### Intercompany Pooling Agreement

The Company, its parent, Balboa Insurance Company (BIC), and its affiliate, Newport Insurance Company (NIC), participate in a Property and Casualty Companies Pooling Agreement (Pooling Agreement), effective January 1, 2005. Under the terms of the agreement, all business, net of non-affiliated reinsurance, is pooled. The pooled premiums, losses, and expenses are reapportioned and shared by the three companies, using the following percentages: 92% for BIC, and 4% each for the Company and NIC. The Pooling Agreement was approved by California Department of Insurance on April 4, 2005.

### Assumed

The Company's assumed business consists entirely of the results of the Property and Casualty Companies Pooling Agreement, and it reported assumed premiums and liabilities totaling \$66.0 million and \$46.2 million, respectively, as of year-end 2008.

### Ceded

The Company cedes to the Property and Casualty Companies Pooling Agreement, net of all external reinsurance. Under the terms of its external reinsurance programs, the largest net amount retained by the Company is \$1 million on any one risk for property and casualty lines. The following is a summary of the principal external reinsurance agreements in force as of December 31, 2008.

Type of Contracts	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Property – Excess of Loss			
Property Excess of Loss	Various/Authorized (73%) and Unauthorized (27%)	\$1 million per risk	\$4 million excess of \$1 million (1)
Casualty – Excess of Loss			
First Casualty Excess of Loss	Various Authorized	\$1 million per risk	\$4 million excess of \$1 million (2)
Second Casualty Excess of Loss	Various Authorized	None	\$5 million excess of \$5 million (3)

(1) Not to exceed \$10 million as respects any loss occurrence involving two or more risks.

(2) Not to exceed \$4 million as respects any one loss occurrence or \$8 million in all during the term of the agreement.

(3) Not to exceed \$5 million as respects any one loss occurrence or \$10 million in all during the term of the agreement.

Under the terms of a Strategic Alliance Agreement (Alliance Agreement) and quota share agreement, the Company ceded 50% of its direct high value homeowners business related to the Alliance Agreement to Atlantic Mutual Insurance Company (Atlantic Mutual). Effective December 31, 2007, the Company and Atlantic Mutual terminated the Alliance Agreement and related quota share agreement. ACE American Insurance Company (ACE) agreed to 100% reinsure this direct business under a quota share agreement with the Company, effective December 31, 2007. Under this agreement the Company continues to share in the losses occurring prior to January 1, 2008. The Company has no liability for losses occurring on or after January 1, 2008.

The Company reported ceded premium and reinsurance recoverables with ACE of \$7.6 million and \$7.6 million, respectively, as of year-end 2009 and \$14.0 million and \$7.1 million, respectively as of year-end 2009.

The Company continues to cede business under a 100% quota share reinsurance agreement with Yosemite Insurance Company, effective January 1, 2004. The coverage is for lender placed



(primarily residential property) and creditor placed (motor vehicle) insurance policies. As of year-end 2008, the total ceded premiums and reinsurance recoverables were \$0.46 million and \$0.45 million, respectively.

Effective January 1, 2007, new or amended fronting agreements are subject to the requirements of California Code of Regulations (CCR) Title 10, Chapter 5, subpart 3, Article 3 2303.15(b), which requires insurers to retain 10% of direct premiums written per line of business, except for cessions to affiliates. A review of the Company's direct premiums written per line of business and ceded premiums to non-affiliates per line of business, as of year-end 2008, confirms that the Company retained greater than 10% per line of business.

The above mentioned quota share cessions, along with other property and casualty reinsurance cessions in force, are reflected in the following table of reinsurers:

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Other Property/Casualty Reinsurance Treaties			
100% Quota Share Homeowners, Auto, Umbrella, Valuables, Watercraft and Other	ACE American Insurance Company (Authorized)	0%	100%
65% Quota Share Basic Renters	ICOM Limited (Bermuda) (Unauthorized)	35%	65%
100% Quota Share Lender and Creditor Placed	Yosemite Insurance Company (Authorized)	0%	100%

For property losses from a single catastrophic occurrence such as a hurricane, the Company purchases property catastrophe excess of loss reinsurance. During the 2008 hurricane season, the Company retained the liability for the first \$50 million of paid losses for any one loss occurrence and purchased \$1.0 billion of reinsurance coverage (in six layers), which includes a three year catastrophe bond of \$50 million within the top reinsurance layers. The Company also purchases aggregate coverage that protects the Company against multiple retentions and that has been tailored to the \$50 million retention. The coverage provided by the property catastrophe excess of loss reinsurance and aggregate coverage is summarized as follows:

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Property – Catastrophe			
First Property Catastrophe Excess of Loss	Various/Authorized (29%) and Unauthorized (71%)	\$50 million per occurrence	\$75 million excess of \$50 million (1)
Second Property Catastrophe Excess of Loss	Various/Authorized (40%) and Unauthorized (60%)	None	\$75 million excess of \$125 million (2)
Third Property Catastrophe Excess of Loss	Various/Authorized (35.75%) and Unauthorized (64.25%)	None	\$150 million excess of \$200 million (3)
Fourth Property Catastrophe Excess of Loss	Various/Authorized (28.9%) and Unauthorized (71.1%)	None	\$250 million excess of \$350 million (4)
Fifth Property Catastrophe Excess of Loss	Various/Authorized (33.1%) and Unauthorized (52.6%)	14.3% participation in the layer (\$50 million covered by Cat bond)	\$350 million excess of \$600 million (5), 85.7% payout

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Sixth Property Catastrophe Excess of Loss	Swiss Re America (Authorized)	None	\$100 million excess of \$950 million (6)
Catastrophe Bond	VASCO Re 2006 Ltd. (Unauthorized)	None	\$50 million
First Catastrophe Aggregate	Tokio Millennium Re Ltd (Bermuda) (Unauthorized)	\$35 million aggregate retention	\$30 million excess of \$35 million (maximum of \$25 million per occurrence)
Second Catastrophe Aggregate	Various/Authorized (56%) and Unauthorized (44%)	\$25 million per occurrence after \$25 million aggregate retention	\$25 million excess of \$25 million (7)

- (1) Not to exceed \$150 million in the aggregate during the term of the contract.
- (2) Not to exceed \$150 million in the aggregate during the term of the contract.
- (3) Not to exceed \$300 million in the aggregate during the term of the contract.
- (4) Not to exceed \$500 million in the aggregate during the term of the contract.
- (5) Not to exceed \$700 million (85.7% payout) in the aggregate during the term of the contract.
- (6) Not to exceed \$200 million in the aggregate during the term of the contract.
- (7) Not to exceed \$50 million in the aggregate during the term of the contract.

For its entire reinsurance ceded program as of year-end 2008, the Company reported total ceded premium and reinsurance recoverables of \$405.4 million and \$242.8 million, respectively. Of the premiums ceded in 2008, \$380.1 million or 93.8% relates to the Pooling Agreement. As of year-end 2009, the Company reported total ceded premium and reinsurance recoverables of \$637.6 million and \$338.0 million, respectively.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2008

Underwriting and Investment Exhibit for the Year Ended December 31, 2008

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2005 through December 31, 2008

Statement of Financial Condition  
as of December 31, 2008

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 117,085,715	\$	\$ 117,085,715	(1)
Cash and short-term investments	5,797,927		5,797,927	
Receivable for securities	437,933		437,933	
Investment income due and accrued	493,398		493,398	
Premiums and agent's balances in course of collection	5,937,146	13,193	5,923,953	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	4,109,762		4,109,762	
Reinsurance:				
Amounts recoverable from reinsurers	19,349,866		19,349,866	
Net deferred tax asset	3,014,517	150,930	2,863,587	
Guaranty funds receivable or on deposit	38,257		38,257	
Receivable from parent, subsidiaries and affiliates	27,155,788		27,155,788	
Aggregate write-ins for other than invested assets	<u>1,476,257</u>	<u>739,277</u>	<u>736,980</u>	
Total assets	<u>\$ 184,896,566</u>	<u>\$ 903,400</u>	<u>\$ 183,993,166</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 9,229,774	(2)
Reinsurance payable on paid loss and loss adjustment expenses			3,214,930	
Loss adjustment expenses			1,914,319	(2)
Commissions payable, contingent commissions and other similar charges			831,285	
Other expenses			329,147	
Taxes, licenses, and fees			336,228	
Current federal and foreign income taxes			1,375,866	
Unearned premiums			34,003,674	
Ceded reinsurance premiums payable			41,605,014	
Funds held by company under reinsurance treaties			430,511	
Remittances and items not allocated			2,853,032	
Provision for reinsurance			114,632	
Payable to parent, subsidiaries and affiliates			1,972,939	
Advance premium			339,661	
Aggregate write-ins for liabilities			<u>611,540</u>	
Total liabilities			99,162,552	
Common capital stock		\$ 5,640,000		
Gross paid-in and contributed surplus		36,547,919		
Unassigned funds (surplus)		<u>42,642,695</u>		
Surplus as regards policyholders			<u>84,830,614</u>	
Total liabilities, surplus and other funds			<u>\$ 183,993,166</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2008

Statement of Income

Underwriting Income

Premiums earned		\$ 64,536,960
Deductions:		
Losses incurred	\$ 22,928,834	
Loss expense incurred	3,567,136	
Other underwriting expenses incurred	16,080,510	
Aggregate write-ins for underwriting deductions	<u>230,400</u>	
Total underwriting deductions		<u>42,806,880</u>
Net underwriting gain		21,730,080

Investment Income

Net investment income earned	\$ 5,766,251	
Net realized capital gains	<u>251,672</u>	
Net investment gain		6,017,923

Other Income

Net loss from agents' or premium balances charged off	\$ (93,653)	
Finance and service charges not included in premiums	262,009	
Aggregate write-ins for miscellaneous loss	<u>(34,646)</u>	
Total other income		<u>133,710</u>
Net income before federal and foreign income taxes		27,881,713
Federal and foreign income taxes incurred		<u>9,790,406</u>
Net income		<u>\$ 18,091,307</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 66,377,805
Net income	\$ 18,091,307	
Change in net deferred income tax	164,079	
Change in nonadmitted assets	79,877	
Change in provision for reinsurance	<u>117,546</u>	
Change in surplus as regards policyholders		<u>18,452,809</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 84,830,614</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2005 through December 31, 2008

Surplus as regards policyholders, December 31, 2005,  
per Examination

\$ 20,390,832

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net income	\$	\$
Change in net deferred income taxes	886,276	
Change in nonadmitted assets	361,312	
Change in provision for reinsurance	1,852,445	
Capital changes: Paid-in	2,820,000	
Surplus adjustments: Paid-in	<u>27,180,000</u>	
Totals	<u>\$ 64,439,782</u>	<u>\$ 0</u>

Net increase in surplus as regards policyholders

64,439,782

Surplus as regards policyholders, December 31, 2008,  
per Examination

\$ 84,830,614

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds

A review of the Company's Annual Statement, Schedule D – Part 1, National Association of Insurance Commissioners (NAIC) bond designations was performed, and it was determined that seven investment designations were not in compliance with the National Recognized Statistical Rating Organization's (NRSRO) ratings. The Company stated that they were utilizing a rating organization that was not on the approved NRSRO list. As a result of this examination finding, the Company stated that it remedied the deficiency by changing its investment guidelines to only utilizing rating organizations on the NRSRO list. In addition, any securities incorrectly designated as filing exempt as of December 31, 2008, were filed with the NAIC Securities Valuation Office.

### (2) Losses and Loss Adjustment Expenses

The Company's loss and loss adjustment expense reserves were reviewed by a Casualty Actuary from the California Department of Insurance. Based on the analysis, the loss and loss adjustment expense reserves as of December 31, 2008, for all companies participating in the inter-company pooling agreement, were determined to be reasonably stated and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

None.



### Previous Report of Examination

Territory and Plan of Operation (Page 8): It was recommended that the Company and Carnegie Agency, Inc. comply with the provisions of the Managing General Agents Act (California Insurance Code Sections 769.80 through 769.87). This finding is a non-issue, as the agency agreement was terminated.

Reinsurance (Page 10): It was recommended that the Company amend its reinsurance agreements to comply with the requirements of Statements of Statutory Accounting Principles 62, Paragraph 7. The Company complied with this recommendation.

Accounts and Records (Page 14): It was recommended that the Company and Balboa Life Insurance Company change their procedures so that premium receipts not associated with the Pooling Agreement are remitted directly to the company that issued the policy. The Company and Balboa Life Insurance Company complied with this recommendation.

### ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/  
Edward W. Aros, CFE  
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Department of Insurance  
State of California